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FOR FREEZER PROVISIONERS

By Bert D. Miner

MARKETING RESEARCH REPORT NO. 453

FARMER COOPERATIVE SERVICE
U. S. DEPARTMENT OF AGRICULTURE

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FARMER COOPERATIVE SERVICE
U. S. DEPARTMENT OF AGRICULTURE

THE Farmer Cooperative Service conducts research studies and service activities of assistance to farmers in connection with cooperatives engaged in marketing farm products, purchasing farm supplies, and supplying business services. The work of the Service relates to problems of management, organization, policies, merchandising, product quality, costs, efficiency, financing, and membership.

The Service publishes the results of such studies, confers and advises with officials of farmer cooperatives; and works with educational agencies, cooperatives, and others in the dissemination of information relating to cooperative principles and practices.

Joseph G. Knapp,
Administrator,
Farmer Cooperative Service,
U.S. Department of Agriculture.

Marketing Research Report No. 453 **June 1961**

This study was conducted under authority of the Agricultural Marketing Act of 1946 (RMA Title II).

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SUMMARY AND CONCLUSIONS

FREEZER provisioners need to exercise initiative and imagination in employing merchandising methods that will improve their operating practices and better meet customers' needs. This is a difficult assignment because of the time, money, energy, and judgment involved.

Recognizing the difficulty of this task, Farmer Cooperative Service, cooperating with the National Institute of Locker and Freezer Provisioners, gathered information on and examined certain merchandising methods. These were credit, delivery, membership, and advertising. The purpose was to outline and appraise techniques used in these areas so that freezer provisioners can use the information in making decisions.

Other facets of merchandising such as packaging, custom cutting, and premiums were not considered in this study.

This report serves as an introduction to the general subject of merchandising practices. Follow-up research is intended, since emphasis on merchandising is a recent development in the industry and operators need to keep up with the progress being made.

Twenty-one active freezer provisioning organizations—some of them farmer cooperatives—contributed information for the study. These firms were chosen to reflect a cross section of the industry with regard to location, sales, services, and ownership. The author observed the operations of each firm and gathered information in accordance with a prepared schedule of questions. Additional information came from published literature and informal interviews with industry leaders.

The capsuled findings of this report follow:

- Consumer credit played an important part in the successful operation of the 21 freezer provisioning firms studied. Two-thirds of them offered customers the benefits of installment account credit. The other one-third offered open account credit only.

Offering consumer credit required access to large amounts of capital to be successful. This applied especially to those firms operating freezer-food programs. Three distinct systems of installment financing were employed to supply the necessary capital: (1) Note assignment, (2) company funds, and (3) direct loans.

Note assignment was the most frequently used and complex method. It was used by 14 of the 15 firms

selling homefreezers. A major benefit of the note assignment method of financing was that it allowed these freezer provisioners to sell their goods on credit without tying up large sums of working capital.

Six points to consider in note assignment are: (1) Credit appraisal, (2) extent of recourse, (3) reserve requirement, (4) delinquency, (5) length of financing period, and (6) carrying charges.

• Credit and delivery service seemed closely related in encouraging customers to buy frozen foods in large quantities.

The main advantages of delivery service to customers were summed up in the convenience it offered. To freezer provisioners it offered opportunities (1) to build strong personal ties with customers, and (2) to increase business volume.

Disadvantages to customers were the possible inconvenience of determining a mutually agreeable delivery date and time plus the possible loss of psychological satisfaction derived from shopping. Freezer provisioners were confronted with the problem of generating income to cover the costs of delivery service. A moderate charge for delivery service may help alleviate this problem. It may partially cover delivery costs without materially discouraging customers from making large purchases.

To be most effective delivery service needs to be tailored to the particular freezer provisioning operation and the market area served.

• Regarding membership, the freezer provisioners interviewed had three general policy alternatives:

1. To provide unrestricted sales to all customers,
2. To institute differential pricing between members and nonmembers,
3. To restrict services to members only.

Thirteen of the 21 operators decided in favor of alternative No. 1. This was an easy choice for 7 of the 13 since they did not sell homefreezers and, therefore, were not faced with such problems as inequality between members and nonmembers, selling homefreezers, and maintaining a freezer sales staff.

One firm used alternative No. 2 but was considering changing to No. 3.

The remaining seven firms selected alternative No. 3. This approach seemed to solve a dilemma because it allowed their salesmen to call upon almost any family whether or not the family already owned a homefreezer.

• The importance of advertising varied from one firm to another. The amount spent on advertisements and promotion ranged from practically nothing to about 6 percent of sales. The weighted average approached 1 percent of sales. Most firms agreed that a formal, paying, referral system was one of the most effective means of advertising available to freezer provisioners.

Merchandising Practices

FOR FREEZER PROVISIONERS

By Bert D. Miner
Frozen Food Locker Branch
Purchasing Division

FREEZER provisioners—or those who supply frozen food locker renters and homefreezer owners—are faced with changing economic conditions. Adjusting to these changes calls for courageous and imaginative merchandising which encompasses all the methods, techniques, and innovations a freezer provisioner can employ to attract customers to his products.

Customers have much broader choices available to them now than they had during the war years and immediate postwar years. They also have additional purchasing power to pay for the things they want. A bare product standing by itself lacks customer appeal. Therefore, most freezer provisioners would benefit by dressing up the product and surrounding it with inviting services. The benefit comes from evaluating merchandising methods and deciding which combination will have the greatest drawing power. This is not easy;

NOTE.—The author expresses appreciation to the managers and officials of the 21 freezer provisioning firms who willingly contributed information and allowed him freedom to observe their operations. He also appreciates the suggestions in all phases of this study of L. B. Mann and Paul Wilkins of the Frozen Food Locker Branch.

it requires time, money, energy, and judgment. Pressed for time and money, many freezer provisioners make decisions based on superficial appraisals or even on little more than hunches or guesses.

Because of the need for assistance in this area of merchandising, the National Institute of Locker and Freezer Provisioners asked the Frozen Food Locker Branch of Farmer Cooperative Service to undertake research in this area.

The Service first made a survey of 2,500 locker and freezer provisioning establishments to determine the nature of their merchandising practices.[1] Findings emphasized the need for more studies of various merchandising methods. This report is the first in a series of studies on the merchandising practices of these firms.

The purpose of this study was to outline and appraise four basic aspects of merchandising as they relate to freezer provisioning. These are credit, delivery, membership, and advertising. Such a study should help freezer provisioners better appraise their own operations in terms of these areas of merchandising.

The writer recognizes there are other facets to merchandising of interest to freezer provisioners, but they were not considered in this study. It only introduces the subjects discussed, and followup research will probe deeper into some of these areas.

Detailed study of 21 freezer provisioning organizations—including two cooperatives—informal observation of other plants, interviews with persons active in the industry, and published literature provided the data for this report. These 21 firms were selected to reflect a cross section of the locker and freezer provisioning industry regarding location, sales, services, and ownership. In the industry are approximately 10,000 firms, of which about 600 are farmer cooperatives. A description of the general features of the 21 organizations studied is presented in the appendix.

Results of the study are presented under four major headings: Credit, delivery service, membership, and advertising. Credit is examined first because of its particular importance to the industry in selling food and freezers. The discussion considers open account credit and then centers on installment account credit with special attention devoted to note assignment. Delivery service is treated next because of its interrelationship with credit. From delivery service the discussion moves to membership and then to advertising.

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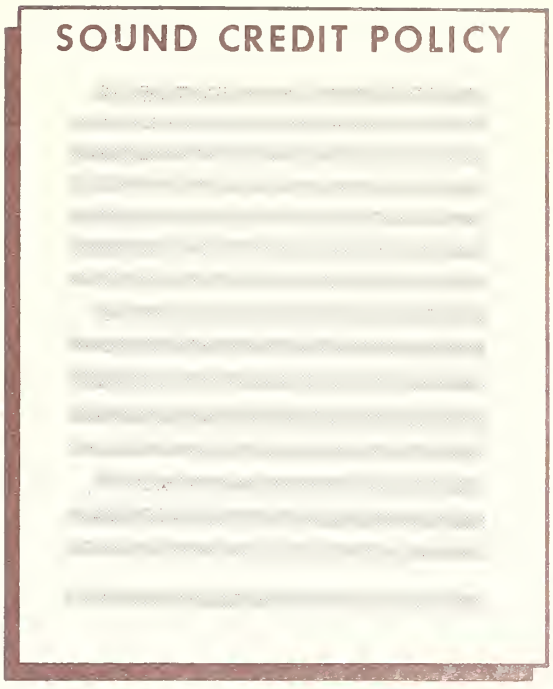
[1] Bert D. Miner. "Merchandising Frozen Food by Locker and Freezer Provisioning Plants," Marketing Research Report 313, Farmer Cooperative Service, U.S. Department of Agriculture, April 1959.

Credit



FREEZER provisioners are looking for ways to increase their returns. This involves increasing sales while controlling costs. Extending credit is one way of increasing sales. Its success, however, depends largely on controlling costs in relation to these increasing sales.

One way to visualize what is involved in extending credit is to think of the loan department of a bank. Here the basic function is lending money. In doing this, a bank incurs a variety of costs; to cover these costs and make reasonable returns, a bank charges interest on the money it lends. Important in this example is that banks normally develop a sound loan policy and then put it into practice with adequate procedures and controls.

Freezer provisioners who extend credit are in effect taking on the banking function of lending money. It follows, then, that these firms need to take a leaf from banking's book of experience and bend every effort to formulate reasonable and sound credit policy, procedures, and controls. This is not the end. The crucial point is that these tools of management are helpful only if *used*. Thus employees must know what they are and how they are to be used.

This report considers two main kinds of credit—open account and installment account. Open account credit is credit that becomes due and payable in full at stated regular intervals, quite often monthly. There is no carrying charge involved. In installment account credit a specified amount of the total becomes due and payable at stated regular intervals, frequently on a monthly basis like open account credit. Unlike open account credit though, installment account credit nearly always requires a carrying charge.

Open Account Credit

One-third of the 21 firms studied offered the service of open account credit to customers. The main reason given for extending this service was that it increased sales. The principal reasons suggested for this fact were:

1. Credit buying had general social acceptance.
2. Lack of cash did not prevent customers from buying.

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3. Customers did not have to carry large sums of cash on their persons.

4. One check drawn at the end of an accounting period covered many purchases and provided a customer with a permanent record.

5. Open account credit allowed a customer to use someone else's money without cost to himself.

6. Credit customers bought more than cash customers.

These explanations suggest that it would be reasonable to expect sales to increase if open account credit were extended to customers. They do not, however, indicate how much sales might increase. Each operator would need to estimate such an increase from an appraisal of the conditions existing in his market area. This evaluation would include present conditions and anticipated changes.

Such an appraisal would determine what effect this estimated level of sales might have on the organization's cost structure. If the additional sales brought more efficient use of facilities and personnel, then the reduced cost for each unit of product handled might be enough to offset the costs incurred from selling on open account credit.

Whether or not efficiency increases sufficiently to absorb the added costs depends largely upon the amount of added costs. An operator can exercise considerable control over these costs by consistently following a well-thought-out credit policy or S.O.P. (Standing Operating Procedure). This means thinking through and writing down the procedure to be used in extending open account credit. This is an area in which many of the firms studied have an opportunity to improve.

The study suggested four main points an operator needs to consider in setting up or revising a credit S.O.P. They are as follows:

1. Who in the firm will handle credit operations? All phases of the credit operation should be pulled together and placed under one person's jurisdiction. Depending on size of the business, the credit operation may require part-time attention of one person or the full time of several people.

2. For how long a period will credit be extended? The answer to this question is vital because it directly influences the amount of working funds a firm will have tied up in credit outstanding at any given time. For example, suppose a firm has 200 customers who buy an average of $15 worth of goods each week. Approximately how much of the firm's working capital will be tied up if the credit period is 7 days, 15 days, or 30 days?

The amount based on a 7-day credit period would be $3,000; based on 15 days, about $6,000; and for 30 days, about $12,000. This example does not include the slow-paying and nonpaying accounts which would increase the amount of tied-up capital and increase credit costs. A periodic inventory of accounts receivable gives an accurate check on the amount of capital tied up in extended credit. It is readily apparent that an operator needs to be careful in extending open account credit that he does not impair the capital structure of his business.

3. Who will evaluate applicants' credit potential? This question needs careful consideration because, as the old saying among credit men states, "An account properly opened is half collected." The potential credit customer should fill out an application which is then evaluated by the operator or for him by his local credit bureau or lending institution.

Whether an account is approved or disapproved, an operator needs to use the utmost tact and courtesy in notifying customers. The notification should be in writing and if the account is approved, the firm's

credit rules should be plainly stated.

4. How will overdue accounts be handled? It is important to treat credit customers courteously, tactfully and understandingly, but delinquency must be handled promptly and firmly. Delinquent accounts increase costs and drive away customers. Operators can reduce the number of slow-paying customers by impressing on them the importance of paying on time. Operators who condone slow paying actually encourage delinquent accounts.

A firm and equitable stand is vital at this point although it may seem difficult. Exceptions to the general policy need to be minimized. The success or failure of the entire credit operation rests predominantly upon the operator's approach to collecting overdue accounts.

Operators we interviewed suggested a number of reasons for requiring prompt payment. The main ones were:

1. Prompt payments mean less capital tied up.

2. The longer accounts are overdue, the more difficult and expensive they are to collect.

3. Paid-up customers are free to make additional purchases.

4. Customers with overdue accounts often trade elsewhere to avoid embarrassment.

5. Customers have more respect for firms that expect and consistently insist on prompt payment.

6. Customers like to feel they are treated equitably.

7. Prompt payments benefit customers by assuring them sound credit ratings.

These observations on open account credit will not resolve all credit problems. Nevertheless, we hope that the experience of the firms studied will assist and encourage other operators to develop well-thought-out credit S.O.P.'s. This could simplify their routine of extending credit and promote understanding within the organization as well as between the organization and its customers.

Installment Account Credit

Installment account, rather than open account, credit better meets the needs of organizations that desire to sell food in bulk quantities and also homefreezers. Two-thirds of the organizations studied offered customers the use of installment account credit. The one-third not offering this service did not sell homefreezers and, therefore, had less need for it.

Firms extending installment credit need to manage such credit programs wisely, because of the large amounts of money involved. A sound and reasonable credit S.O.P. is of the utmost importance. The same questions have to be considered in setting up procedures for handling installment account credit as would be considered for open account credit. Four questions of this nature were discussed briefly in the section on open account credit. These questions also apply to installment account credit except for question No. 2: For how long a period will credit be extended?

The time period for installment account credit will be longer than for open account credit. For instance, the firms studied financed bulk quantities of frozen foods for from 2 to 6 months on installment accounts but for only 30 days on open account. For homefreezers the installment time period ran from 24 to 36 months. No freezers were sold on open account.

Large amounts of financing capital must be available to extend credit to many customers for these relatively longtime periods. The following two examples further clarify this point. The first example (table 1 on page 6) shows the approximate amount of financ-

Table 1.—Volume of capital required to finance home freezer sales under specified conditions [1]

Month	Cumulative total of home freezers sold	Cumulative total of amount financed	Freezer repayment	Capital outstanding at end of month	Interest payment
1	10	$5, 000	[2] $208	[2] $4, 792	[2] $25
2	20	10, 000	417	9, 375	50
3	30	15, 000	625	13, 750	75
4	40	20, 000	833	17, 917	100
5	50	25, 000	1, 042	21, 875	125
6	60	30, 000	1, 250	25, 625	150
7	70	35, 000	1, 458	29, 167	175
8	80	40, 000	1, 666	32, 501	200
9	90	45, 000	1, 875	35, 626	225
10	100	50, 000	2, 083	38, 543	250
11	110	55, 000	2, 291	41, 252	275
12	120	60, 000	2, 500	43, 752	300
13	130	65, 000	2, 708	46, 044	325
14	140	70, 000	2, 916	48, 128	350
15	150	75, 000	3, 124	50, 004	375
16	160	80, 000	3, 333	51, 671	400
17	170	85, 000	3, 541	53, 130	425
18	180	90, 000	3, 749	54, 381	450
19	190	95, 000	3, 958	55, 423	475
20	200	100, 000	4, 166	56, 257	500
21	210	105, 000	4, 374	56, 883	525
22	220	110, 000	4, 583	57, 300	550
23	230	115. 000	4, 791	57, 509	575
24	240	120, 000	5, 000	57, 509	600

[1] The specified conditions are:
a. Number of home freezers sold each month 10
b. Length of the financing period (months) 24
c. Interest rate per year (on full amount of loan) ..... 6 percent
d. Average selling price of each freezer $500
e. Individual monthly freezer repayment $20. 83
f. Individual monthly interest payment $2. 50
g. All monthly installments paid when due.
[2] Rounded to nearest whole dollar.

ing capital required to finance homefreezers under certain assumed conditions. The second example (table 2 on page 7) gives similar data for financing bulk quantities of frozen foods.

Few freezer provisioners have the uniform growth pattern portrayed in table 1. This, however, is a goal well worth striving for because it greatly simplifies the management job of estimating future business activities—planning capital, labor, and inventory requirements; scheduling processing, order assembly, inshipments, and deliveries; and other such activities.

The sale of 10 freezers a month may be considered a small volume by some operators, especially those selling hundreds of freezers each month. Nevertheless, the basic point still holds—a freezer provisioner must have access to considerable capital to finance a successful freezer provisioning program. This fact is plainly demonstrated in table 1. In this case the financing of only 10 freezers a month meant more than $57,000 outstanding at

the end of 24 months. If the monthly sales had been greater, the capital outstanding would have been greater. For example, suppose the monthly sales were 100 a month instead of 10. Then the capital outstanding at the end of 24 months would have been about $575,000 instead of $57,000.

The amounts of capital required to finance bulk food orders are not as great as for financing homefreezers. They can be more risky, however, because food can seldom be repossessed to protect profits or minimize losses while freezers can. Therefore, a knowledge of how food financing works is helpful.

Table 2 shows the general manner in which the financing of bulk food orders works. This is a simplified example but still demonstrates reasonably well what one could expect in the way of capital needs to sell bulk food orders on credit. Here again, as the number of credit customers increases the amount of capital necessary to

Table 2.—Volume of capital required to finance bulk food sales under specified conditions [1]

Month	Initial food orders	Number of repeat food orders					Cumulative number of customers	Value of monthly food business	Monthly food repayment	Capital outstanding at end of month	Monthly interest payment
1	10						10	$1, 600	$400	$1, 200	$16
2	10						20	1, 600	800	2, 000	32
3	10						30	1, 600	1, 200	2, 400	48
4	10						40	1, 600	1, 600	2, 400	64
5	10	5					45	2, 400	1, 800	3, 000	72
6	10	5					50	2, 400	2, 000	3, 400	80
7	10	5					55	2, 400	2, 200	3, 600	88
8	10	5					60	2, 400	2, 400	3, 600	96
9	10	5	5				65	3, 200	2, 600	4, 200	104
10	10	5	5				70	3, 200	2, 800	4, 600	112
11	10	5	5				75	3, 200	3, 000	4, 800	120
12	10	5	5				80	3, 200	3, 200	4, 800	128
13	10	5	5	5			85	4, 000	3, 400	5, 400	136
14	10	5	5	5			90	4, 000	3, 600	5, 800	144
15	10	5	5	5			95	4, 000	3, 800	6, 000	152
16	10	5	5	5			100	4, 000	4, 000	6, 000	160
17	10	5	5	5	5		105	4, 800	4, 200	6, 600	168
18	10	5	5	5	5		110	4, 800	4, 400	7, 000	176
19	10	5	5	5	5		115	4, 800	4, 600	7, 200	184
20	10	5	5	5	5		120	4, 800	4, 800	7, 200	192
21	10	5	5	5	5	5	125	5, 600	5, 000	7, 800	200
22	10	5	5	5	5	5	130	5, 600	5, 200	8, 200	208
23	10	5	5	5	5	5	135	5, 600	5, 400	8, 400	216
24	10	5	5	5	5	5	140	5, 600	5, 600	8, 400	224

[1] The specified conditions are:

a. Number of initial food orders sold each month 10
b. Length of the financing period (months) 4
c. Proportion of initial customers who continually reorder ..... 50 percent
d. Monthly interest rate (on full amount of loan) ..... 1 percent
e. Value of the average food order $160
f. Individual monthly food repayment $40
g. Individual monthly interest payment $1.60
h. All monthly installments paid when due.

finance the expanded volume of business multiplies.

Failure to recognize the fundamental manner in which credit sales affect the financial stability of a firm has been the downfall of many freezer provisioning organizations. With so much business available, some firms gobbled up more business than they could digest or, to put it another way, they sold themselves into insolvency. Other firms awakened to this peril in time to avoid business failure but had to go through a crucial period of financial instability and reorganization. This is a strong argument favoring planned, steady growth on a scale consistent with financial stability.

To appreciate this idea of financial stability, it is necessary to understand the methods of financing used by freezer provisioners. This study revealed three different systems of installment financing—note assignment, company funds, and direct loan. Some firms used a combination of these methods.

Note Assignment

This method was more widely used than either of the others. Two-thirds of the establishments subscribed to it. It was also more complicated than the other two and the details varied from one firm to another. The major emphasis here will be on the general procedure.

Note assignment operated in the following general manner: A freezer provisioner sold a customer a homefreezer and initial food order for $726.40—$500 for the freezer plus $160 for the food order plus $66.40 interest on the freezer-food note. Then the freezer provisioner sold the freezer-food note to a lending institution for the principal amount of the note, $660. Upon being notified, the customer made monthly payments directly to the lending institution.

So the question arises: What was the value of note assignment? The major benefit was that it allowed a freezer provisioner to sell his goods on credit without tying up working capital. For instance, if the freezer provisioner mentioned previously had financed the sale of freezer and food out of working capital, it would have tied up $660. Instead he sold the freezer-food note to the lending institution and hence immediately replenished his working capital. With the purchase of the freezer-food note the lending institution gained legal right to the interest payment to defray its expenses and turn a profit.

This working relationship enabled the freezer provisioners to specialize in providing customers with quality goods and services while the lending institutions specialized in lending money. Experience of the operators interviewed uncovered some weaknesses in this type of arrangement, however, and all freezer provisioners should be aware of them. A more detailed examination of note assignment will help pinpoint the potential weak spots.

Six topics appeared to cover the main points brought up by various operators in explaining the workings of note assignment. They were credit appraisal, extent of recourse, reserve requirement, delinquency, length of financing period, and carrying charges.

Credit Appraisal.—An evaluation of a potential customer's credit standing was considered of the utmost importance. This evaluation was an attempt to correctly answer four basic questions: (1) Who he was, (2) how much credit he could reasonably be expected to carry satisfactorily, (3) whether he could pay, and (4) whether he would pay.

This evaluation was made by the freezer provisioner, the lending institution he was working with, or by the two of them jointly. Regard-

less of who made the evaluation, the freezer provisioner had to be sure that his salesmen obtained a completely filled-out credit application from each new potential credit customer. Such a document was fundamental to the whole credit evaluation.

Since lending institutions usually had considerable experience in appraising credit risks, some freezer provisioners authorized them to approve or disapprove credit applications. This allowed the freezer provisioner to concentrate his attention on other phases of the business with which he was more familiar. It eliminated the possibility of the lending institution refusing to accept some accounts the freezer provisioner might have approved.

A point freezer provisioners needed to watch was that sometimes a lending institution might be too conservative in its appraisal. At other times it might be too liberal. The consequences were quite similar.

If the lending institution was too conservative, the result would be a high rate of rejects and unhappy salesmen. To salesmen credit rejects were lost commissions. Therefore, they attempted to qualify prospects; that is, they tried to select those prospects that they thought would buy and prove good credit risks. If in spite of this the reject rate was high, the better salesmen would seek other employment. This could prove costly to a freezer provisioner because his volume of business dropped off. It was also expensive to continually hire and train new salesmen.

If the financial institution was too liberal, applications might be approved that more prudent judgment would have rejected. Salesmen might not be quite exacting enough in qualifying prospects, the amount paid out in commissions might rise, defaults might increase, expenses might mount while income fell, and the freezer provisioner might have to reorganize quickly to prevent insolvency.

Either one of these conditions could happen even if the freezer provisioner was appraising the credit application unless he was careful to maintain a balanced approach. The freezer provisioner, however, had an intense personal interest in seeing that each application was reasonably and objectively evaluated. The lending institution did not have this same intensity of interest.

The reason this difference existed was that the lending institution did not share equal risk with the freezer provisioner when a credit sale was approved. This point will be elaborated further in the section covering recourse.

From the foregoing discussion it seems quite apparent that credit appraisal is an important part of credit extension. Therefore, the prudent freezer provisioner will do well to familiarize himself with what is involved and what points to emphasize in credit appraisal.

He can get information by talking with a representative of the local credit bureau or bank. Armed with this knowledge, he is in a better position to decide which alternative best suits his operation and can talk more intelligently with the representative of the lending institutions with which he does business.

If a freezer provisioner decides to handle credit appraisal within his own organization, he may still wish to consult his local credit bureau and the lending institution with which he is dealing. On the other hand, he may decide to have the lending institution appraise credit potentials for him while retaining for himself the final decision in questionable cases. This was the approach favored by a majority of the firms studied.

Regardless of the approach used,

an operator should strive to promote understanding and harmony between his company and the lending institution. Nevertheless, he should use all the strong points he can muster in negotiating the most favorable terms possible with the lending institution. This is not a one-time proposition. The initial arrangements may be less desirable than a freezer provisioner wants but he may be able to exact more favorable terms later on. This is especially important with regard to recourse and reserves.

Extent of Recourse.—Recourse means the extent to which a freezer provisioner is liable on any food and freezer notes he assigns to a lending institution. It is similar to an individual acting as a cosigner on a personal note. If the person obtaining the loan fails to repay it, the cosigner is legally responsible to do so.

Thus a freezer provisioner, in effect, acts as a cosigner with each of his credit customers if a lending institution has recourse on him. Under this type of arrangement a freezer provisioner assumes the major part of the risk while the lending institution collects the interest.

Despite the apparent one-sidedness of this type arrangement, the freezer provisioner still benefits because he has access to funds for financing credit business. Without this source of funds he would be greatly restricted in the volume of credit business he could carry. This could mean under-utilization of plant capacity and hence increased unit costs.

The extent of recourse varied among the firms studied. Naturally it applied only to those firms using note assignment to finance food and freezer sales.

Only four of the eight firms using note assignment to finance food sales were fully liable on these notes. The other four were not subject to any recourse. The lending institutions with which the latter firms dealt assumed the full risk of nonpayment.

Conversely, 11 of the 14 firms using note assignment to finance homefreezer sales were subject to full recourse. One was obligated to the extent of 50 percent; another was relieved of all recourse; and another had a dual arrangement. The latter had a full recourse arrangement with a bank and a nonrecourse arrangement with a finance company.

Although full recourse arrangements were in the majority, it was possible for some firms to obtain more favorable arrangements than others. It was also possible that the firms subject to full recourse had not attempted to renegotiate more favorable terms.

In general a freezer provisioner realizes that a lending institution is not likely to relinquish its favored position automatically; he should take the initiative to renegotiate. The more he is able to reduce the extent of recourse, the less risk he must bear. It may be possible to eliminate the recourse feature entirely, in which case the lending institution then assumes the full risk of people not repaying their loans.

A lending institution that assumes more of the risk will also want more voice in approving credit applications. It may also become much more conservative and approve only those applications it considers certain to repay. This situation could lead to a high rate of rejects, and the problems associated with it as discussed on page 9. It becomes apparent, therefore, that freezer provisioners and lending institutions need to have a good understanding of each other's business and a close working relationship.

Reserve Requirement.— Freezer provisioners we interviewed were concerned with reserve requirement because it could have a greater direct impact on business than the extent

of recourse. This was because it tied up working capital. Here is how it worked in general:

A freezer provisioner sold a homefreezer or bulk food order on credit and then sold the note to a lending institution. Instead of handing over to the freezer provisioner the full amount of the note, the lending institution gave him only a portion of it and retained the rest in a reserve account. The amount retained belonged to the freezer provisioner.

The fact that the money held in reserve belonged to the freezer provisioner helped him little, however, when he was looking for working capital. It simply was not available to him for use. He had to rely upon other resources. Of course, the amount withheld in reserve determined the extent of its impact on the business.

All 14 of the firms interviewed that used note assignment to finance freezer sales were required to maintain a reserve account with their lending institutions, but the amount varied. In a few cases the reserve was a flat sum regardless of the total amount of loans outstanding. Generally, however, it was a stated percentage of the total amount of loans outstanding. It ranged from 5 to 20 percent with 10 percent being the most frequently stated figure.

Reserve requirement was less important in financing repeat food orders. Only three of eight firms using the note assignment method of financing repeat food orders were required to maintain dealer reserves with their lending institutions. The requirement ranged from 5 to 10 percent of the value of food notes outstanding.

The simple calculations in table 3 demonstrate the amounts of capital tied up in dealer reserves based on different percentages and varying amounts of loans outstanding. These would be the amounts of working funds directly withheld from an operator's immediate use. Indirectly he would lose the use of additional funds because under Federal tax regulations he would be required to pay income taxes on the reserve funds for the year they went into the reserve account rather than at the time they were released to him for use.

This requirement means a freezer provisioner may have to use some of his working funds to pay taxes on earnings before these earnings actually became available for his use.

Operators need to be aware of the serious impact these two drains on capital could have on the financial condition of a freezer provisioning organization. When net earnings fail to provide sufficient working

Table 3.—Amount of money tied up in reserve under specified amounts of money outstanding and reserve percentages

Amount outstanding	Amount held in reserve			
	5 percent	10 percent	15 percent	20 percent
$20,000	$1,000	$2,000	$3,000	$4,000
40,000	2,000	4,000	6,000	8,000
60,000	3,000	6,000	9,000	12,000
80,000	4,000	8,000	12,000	16,000
100,000	5,000	10,000	15,000	20,000
200,000	10,000	20,000	30,000	40,000
500,000	25,000	50,000	75,000	100,000

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capital, a firm must resort to debt capital or equity capital to fill the gap. Borrowing may further impair the firm's financial condition and more equity capital may dilute earnings on investment.

Faced with these circumstances an operator is in a dilemma as to what action to take. From the number of firms that have discontinued operation, it is apparent that the solution is not an easy one. Some firms that have survived such a crisis have done so primarily because of a major reorganization that strengthened their financial structure.

Since the impact of dealer reserves on the liquidity of the business is in direct relation to the amount of reserves withheld, it is to the advantage of a freezer provisioner to unceasingly seek a lower reserve requirement. If operating experience warrants such a reduction, the lending institution may be convinced. Why may this be so? The answer lies in an understanding of the purpose of a dealer reserve.

A dealer reserve serves as a risk reducing device for lending institutions. This is how it works:

Freezer provisioner A has a full-recourse, 10-percent reserve financing arrangement with lending institution B. During a given period of time, freezer provisioner A sells 10 homefreezers for $500 each, excluding carrying charges. In turn, he sells the notes on these 10 freezers to lending institution B.

Lending institution B pays freezer provisioner A $4,500 and retains $500 in a reserve account. The customers make their repayments promptly to the lending institution for a while and then one of them fails to make a scheduled payment.

Lending institution B follows its regular procedure in attempting to collect but is unsuccessful. Since it has full recourse on freezer provisioner A, it simply sells the note back to operator A for the amount of the unpaid principal. This is accomplished by transferring funds from freezer provisioner A's reserve account to the account of lending institution B.

Thus a dealer reserve is a more or less guarantee to a lending institution that a freezer provisioner will have funds to repurchase uncollectible notes.

Delinquency.—The need for handling delinquency promptly was a concern of all operators interviewed. They generally held the view that a few accounts would become delinquent, regardless of the care used in evaluating credit risks, because some customers would suffer an actual or imagined injustice. These needed to be handled with dispatch to preserve the integrity of the credit system. The operators also believed that prompt and courteous explanation or settlement would be more likely to collect the money and retain the customer than an alternate policy.

For the 21 firms studied, the initial contact was usually made within from 7 to 15 days. The means of communication varied—post card, letter, telephone call, or personal visit. Some firms had well-developed procedures to be followed in the various stages of collection. Others treated each new delinquent account as a special problem to be handled as it developed. The former system appeared to be more efficient.

Operators expressed the view that the procedure used should aim to achieve two main objectives: (1) Collect the money, and (2) retain the customer. The following procedure is given as a guide to attain these goals. Although it does not duplicate exactly the procedure used by any of the 21 organizations studied, it does closely parallel a number of them.

When an account is 7 days past due, the customer is sent a friendly, inquiring letter. If he responds, the

account is either collected or an agreement is reached to settle it.

But if there is no response by the end of 15 days past the due date, the customer receives a more formal and sterner letter. This letter specifies the overdue nature of the account, the amount due, and the general conditions of credit extension and asks the customer to communicate with the firm.

If the customer responds, the account can be settled at this point. If, however, this latest reminder brings forth no response within 10 days, the operator or his lending institution tries to make telephone or personal contact. If this is unfruitful, the delinquent account may be turned over to a collecting agency.

More specifically, a freezer provisioner needs to be acquainted with the followup procedures used by his lending institution. He should also receive periodic reports from it giving the status of all accounts. In this way he may be instrumental in reducing delinquencies. Whatever an operator can do to reduce delinquencies, the better off he is because the lending institution usually has full recourse on him for unpaid accounts.

Length of the Financing Period.— There was flexibility in the financing period for each of the 21 firms studied. The financing period for homefreezers ranged from 24 to 36 months. The shorter period was considered more nearly typical.

Then the question arose: What difference did it make? A direct relation existed between length of financing period and amount of funds tied up in financing. The direct impact rested upon the freezer provisioner only if he used company earnings to finance sales. Those who financed by note assignment felt the impact of these extra funds outstanding in an indirect manner. First, the amounts withheld in dealer reserves were larger, and second, lending institutions sometimes limited the dollar volume of business they were willing to transact with these provisioners.

It seemed logical, therefore, for freezer provisioners to emphasize the shorter financing period. The shorter period was favorable to customers, also, because it reduced their total carrying charges. On the other hand, the longer financing period reduced customers monthly payments and made it easier for them to fit the payments into their budgets.

In the accompanying tabulation is an example of the size of the monthly principal and interest payment, in relation to the length of the financing period, on $500 principal with interest at 6 percent a year on full amount of the loan.

Monthly payment	Length of the financing period		
	24 months	30 months	36 months
Principal	$20.83	$16.67	$13.89
Interest	2.50	2.50	2.50
Total	23.33	19.17	16.39

This tabulation shows that lengthening the repayment period from 24 to 30 and 36 months causes a significant drop in the amount of monthly payment. In fact, the monthly payment based on 36 months is 30 percent smaller than that based on 24 months. However, the luxury of these lower monthly payments costs the customer an additional $30 in carrying charges.

General experience indicates that customers are far more concerned with the amount of the monthly payment than they are with carrying charges or total amount of the debt. Freezer provisioners, nevertheless, may be able to strengthen

their public relations by explaining to customers the consequences of low monthly payments based on a longer repayment period.

Besides, a freezer provisioner generally does not make any more money by financing for a longer period. Moreover, his risk may be increased by poorer credit risks and a longer time period in which delinquencies can arise as well as by general economic uncertainty. These points suggest it would be wise to limit the freezer financing period to 24 months normally. Special situations may arise when an extension of the repayment period is warranted in the interest of both parties.

Among the firms studied, the length of the financing period for food ranged from 2 to 6 months with 4 months being most frequently used. The length was based primarily upon two conditions: (1) Amount of the food order, and (2) size of the family. For example, a $150 order might last a family of two adults for 6 months. Conversely, a similar size order might last a family of two adults and two children for only 4 months or an even larger family for only 2 months.

There were a few cases where big families purchased large enough orders to last them 4 months but their homefreezers were too small to store the whole order. In such cases freezer provisioners arranged the order in two relatively equal and similar parts and then made two deliveries about 2 months apart.

Although food orders varied considerably in dollar amount, it was useful for planning purposes to know the average size. They averaged $140 and were normally financed over a 4-month period. They comprised approximately 75 percent meat. Commercial frozen fruits and vegetables, along with prepared foods, made up the remaining 25 percent.

Data like these will be helpful in scheduling procurement so that freezer provisioners can maintain reasonable and balanced inventories. Each organization needs to obtain such size and composition information for its own operation if it is to be most useful. On the selling side such data are less useful because orders have to be adapted to the individual wants of customers. Variety of products and flexibility in the length of the financing period allow freezer provisioners to more nearly fulfill these varied demands. The length of the financing period also influences the total amount of carrying charges assessed on any particular order.

Carrying Charges.—Among the freezer provisioners included in the study and their lending institutions, charges for financing homefreezers and bulk food orders varied widely. In trying to compare these charges, difficulties arose. First, carrying charges were not the same as interest. Second, carrying charges were not even comparable among themselves. Third, there were different ways to calculate the rates. An examination of these points will help one better appreciate the complexity of carrying charges.

As we all know, interest is a charge for the use of someone else's money. This term is generally understood and accepted. People who borrow money expect to pay for its use. For example, Mr. Jones arranges to use $100 of Mr. Brown's money for a year and agrees to repay the $100 plus a $6 charge for its use at the end of that time. Obviously the $6 represents interest.

Carrying charges are more complex because they not only include a charge for the use of money but also charges for other services. It is this latter point that makes carrying charges elusive. They can vary from one firm to another

because of the different services included in the calculation. Moreover, they can vary even if the same services are included because of the different estimated costs of extending those particular services.

The methods of calculating rates of importance to freezer provisioners are the "full loan" and "declining balance" methods. These are contrasted in table 4. The same size loan, $720, with 24 equal installments is used for both methods. Column 3 shows the amount of money the borrower has available for use each month. This has significance in determining the effective rate to be used in setting carrying charges.

First, however, examine column 4. Here the borrower has been granted a $720 loan to be repaid in 24 installments of $30 each. Return on the loan is at the rate of 6 percent a year on the *full loan* and is to be paid monthly.

Total return amounts to $86.40. This total contrasts sharply with the $45 received, if the return is calculated on the declining balance as shown in column 5. This difference in total return exists in spite of the fact that both methods quote an annual rate of 6 percent.

The technical defect lies in the full loan method. A borrower making monthly repayments lessens the amount of a loan he has avail-

Table 4.—Two different methods of calculating carrying charge rates

Number of months	Monthly payment on the principal	Amount of principal available for use each month	Amount of monthly carrying charges based on 6 percent per annum	
			Full loan	Declining balance
(1)	(2)	(3)	(4)	(5)
1	$30	$720	$3. 60	$3. 60
2	30	690	3. 60	3. 45
3	30	660	3. 60	3. 30
4	30	630	3. 60	3. 15
5	30	600	3. 60	3. 00
6	30	570	3. 60	2. 85
7	30	540	3. 60	2. 70
8	30	510	3. 60	2. 55
9	30	480	3. 60	2. 40
10	30	450	3. 60	2. 25
11	30	420	3. 60	2. 10
12	30	390	3. 60	1. 95
13	30	360	3. 60	1. 80
14	30	330	3. 60	1. 65
15	30	300	3. 60	1. 50
16	30	270	3. 60	1. 35
17	30	240	3. 60	1. 20
18	30	210	3. 60	1. 05
19	30	180	3. 60	. 90
20	30	150	3. 60	. 75
21	30	120	3. 60	. 60
22	30	90	3. 60	. 45
23	30	60	3. 60	. 30
24	30	30	3. 60	. 15
	720	0	86. 40	45. 00

able for use during succeeding months.[2] But he is charged as if he had the full amount of the loan available for use each and every month of the repayment period. The full loan method is accepted business practice despite its technical weakness.

The declining balance method (column 5) shows the borrower pays carrying charges only on the actual amount of money he has available for use from month to month. The monthly rate of return to the lender is the same as for the full loan method—one-half of 1 percent. The difference is that this rate is multiplied by a declining amount of principal each month (column 3) to give the different monthly carrying charges shown in column 5.

The quoted rates in these two examples are identical, 6 percent a year. The quoted rate and the effective rate are also identical in the declining balance method. In the full loan method, however, the quoted rate and the effective rate are strikingly different—6 percent against about 11.5 percent a year.

To determine the effective rate the main question to be answered is: What amount of money does the borrower have available for use? If a borrower has use of $720 for a full loan period (24 months), and is charged $86.40, the effective annual rate is 6 percent. The point is: Installment credit does not work that way.

In the case of installment credit a borrower has the use of the full amount of the loan for only the first month. Each month thereafter the amount available for use decreases by the amount of the monthly principal payment; for instance, the declining amounts shown in column 3, table 5. Here the borrower has use of $720 the first month; $720 minus $30 or $690 the second month; and $690 minus $30 or $660 the third month. By the 24th month he has use of only $30. Over the whole loan period then, the borrower has available for use only about half of the full installment loan.

So what does this all mean to freezer provisioners? It means they have considerable latitude in setting carrying charges to cover the costs of services provided. It also means they have an opportunity to explain these carrying charges to their customers so the customers can more adequately appreciate the values received.

This latter point is illustrated by an example drawn from the price-education bulletin of a Canadian freezer provisioner. He explained beef prices to his customers as follows:

"Beef Prices—For the last 3 years we have been faced with ever increasing beef prices. We feel we can tell our customers there will be no further increases in beef prices during 1960. There is every indication that American beef production has caught up with U.S. consumption and the movement of Canadian cattle to the States will gradually slow down. This was reflected in the December beef carcass prices.

"There will be no great immediate price reductions. Anticipating a weaker beef market our January prices on beef packs are lowered. Prices on hinds, fronts and sides custom cut will be quoted on a day-to-day basis depending on the market. We feel the price break in beef will come with the spring run of beef cattle to market beginning in April. Prices will likely remain near the present level until that time."

This freezer provisioner appreciated his customers and tried to

[2] The repayments could be monthly, semimonthly, biweekly or weekly. Regardless of the installment repayment schedule, the declining balance principle would be operative.

keep them informed. While the statement did not center on an explanation of carrying charges, it is not difficult to visualize such a statement appearing in one of his monthly price-education bulletins.

Any freezer provisioner can use this approach to communicate with his customers and thus build their confidence in his organization. Confidence is prerequisite to repeat business and repeat business directly influences business volume.

Other Methods

The other two financing methods used by provisioners covered in the study—company funds and direct loan—were less complex and more limited in use. They are, therefore, treated only briefly in this report.

Company Funds.—One-third of the 21 freezer provisioning firms used company funds to finance bulk food orders. This does not mean that their entire credit food business was financed with company funds. It only means that some portion of it was and the amount varied from firm to firm. On the other hand, none of these firms used company funds to finance homefreezer sales.

With this method sales were financed out of company earnings. Organizations relying solely upon earnings as a source of financing capital greatly restricted their sales potential. It was apparent, too, that this method was much better suited to financing bulk food orders than to financing homefreezers. This was because of the smaller amounts of funds needed to finance bulk food orders.

Direct Loan.—The direct loan method of financing meant a freezer provisioner obtained a direct loan, such as a mortgage on the plant, from some lending institution and then used these funds to finance sales. This method had little general acceptance among the firms studied. Only three indicated they used it. One firm used it as a partial source of funds for financing homefreezer sales. The other two mentioned it as their sole source of funds for financing bulk food sales.

Delivery Service

THE FREEZER provisioners included in this study reported varying ideas on the value of food delivery service. This is illustrated by the following comments:

"Credit and delivery are two big items that give freezer provisioners character apart from a self-service grocery store."

"Don't deliver unless forced to. Costs too much to handle. Most people served are in town shopping at least once a week and can easily pick up purchases at the plant."

"Don't encourage pickup at the plant because it interrupts the work schedule."

"Don't encourage delivery."

These statements emphasize that each freezer provisioner needs to appraise the value of adding services in light of his own operation. Topics in this section are arranged to assist freezer provisioners in deciding whether or not to offer home delivery service and to bring to their attention certain key factors that influence its efficiency.

The sequence of topics is as follows: Need for service, advantages, disadvantages, systems, personnel, free delivery, and courtesy and efficiency.

Need for Service

The basic consideration in offering any consumer service lies in the answer to the question: Does this service meet a consumer need? A meaningful answer to this question implies that the service will be profitable in and of itself or through its favorable influence upon other activities of the firm.

The diverse nature of freezer provisioning organizations makes the latter approach more realistic. For instance, the chain effect may be somewhat along the following line: Food delivery service attracts new customers; plant volume expands; more efficient use of plant, equipment and personnel reduces unit costs; prices remain competitive; margins increase; and profits improve.

This is a much simplified illustration; yet it suggests a chain of effects that need to be considered in arriving at a reasonable estimate

of the impact of a new service on the business. It also suggests that the impact will be related to the increased volume of business. The cost of instituting and operating a delivery service needs to be offset by increased revenue. Unless a special charge is made for delivery service, the increased revenue must come from expanded sales.

In the case of expanding sales, delivery service and credit extension are closely allied. Installment credit and delivery service encourage large-quantity purchases. Furthermore, selling in bulk quantities is fundamental to the whole idea of freezer provisioning as to both the added convenience it offers homemakers and the distinguishing character it lends to freezer provisioners.

It is evident that the decision on whether or not to offer delivery service is related to the question of credit and can have a rather profound effect upon the entire scope of the business. Further, the idea of delivery service is not a single, fixed type. There are many variations. Therefore, the solution to the question of delivery service should be based on a reasonably objective appraisal of the pertinent facts.

Advantages of Service

The advantages of delivery service outweighed the disadvantages in the opinions of 14 of the 21 firms studied. And what were these advantages? Essentially they divided into two groups: those accruing to the customer and those accruing to the freezer provisioner. The main advantages to the customer were summed up in the convenience it offered (filled a customer need). Convenience had more drawing power for some customers than others. Delivery service was, therefore, considered more important by some than by others.

The response of customers was a good indication of their feelings. Over 80 percent of them used this service in all except one of the firms offering it. In two firms over 90 percent of the customers preferred to have their orders delivered although they were offered discounts of 2 and 3 percent to pick them up at the plant. Thus it appeared that customers valued the convenience of delivery service. In fact, where it was not freely offered some customers still requested and got it.

The main advantages of delivery service to freezer provisioners, as they themselves saw it, were the opportunities to build strong personal ties with customers, and increase business volume. The first point had a direct bearing upon the second.

People liked to be recognized and treated as individuals, the provisioners thought. In this regard, delivery service offered a freezer provisioner a competitive advantage over his impersonal competitors. The emphasis here was on the fact that he could gain a competitive advantage through personal service.

Such an advantage did not automatically flow from delivery service. It had to be earned by the quality of the service. A customer who was satisfied with such service continued to patronize the business organization providing it. Then it followed that the more satisfied customers a freezer provisioner served the more his business grew. These satisfied customers were also excellent sources of inexpensive advertising to further stimulate business.

Disadvantages of Service

Freezer provisioners included in the study also had to consider the disadvantages before deciding whether or not to offer delivery service. They did not consider the

disadvantages to customers as serious. These were the possible inconveniences arising in setting a mutually agreeable delivery date and time, and the possible loss of psychological satisfaction derived from shopping.

But on the other hand operators had to face up to the prospects of additional costs and a more complex business. The problem was to evaluate these disadvantages in light of the advantages and make a decision. Seven firms concluded the disadvantages outweighed the advantages. This decision meant these firms believed that none of the various delivery systems was appropriate to their operation.

Delivery Systems

This study showed that offering delivery service meant different things to different freezer provisioning firms. One visualized delivery service as a separate division with a fleet of refrigerated trucks and uniformed drivers. Another saw it as a sort of fill-in job for one of the regular employees using a secondhand pickup truck.

Obviously there were a variety of delivery systems. That was what made it possible for widely different firms to offer delivery service. It also helped explain why some were able to offer delivery service to advantage while others were not.

Most operators realized that delivery service needed to be tailored to their operation and market area to be most effective. This meant it needed flexibility to change and grow with the business. There was no good reason for a small operation to purchase a fleet of refrigerated trucks. Such a venture would be doomed from the start. Conversely, a large operation required such a fleet to carry on its business efficiently.

Vehicles used for delivery service were either owned or leased, and refrigerated or nonrefrigerated depending upon which characteristics best suited the particular situation. One firm used the leasing method but the rest owned their delivery vehicles. Another firm had previously leased refrigerated delivery trucks but discontinued that method of delivery. The firm considered it too expensive.

Five firms used refrigerated trucks in their delivery system. Nine packed frozen food into insulated containers and then delivered it in nonrefrigerated trucks. Seven did not deliver. Most plants used pasteboard boxes for assembling orders, whether or not they used refrigerated delivery vehicles. Two plants employed used, 100-pound, 5-ply sugar sacks.

Delivery Personnel

Operators expressed the view that delivery personnel was an important aspect of delivery service. Why was this so? Because delivery personnel were personal representatives of the freezer provisioning organization. As such they could build strong, lasting ties with customers through friendly, courteous, efficient, and conscientious service. Or they could shatter a customer's confidence by a careless word or thoughtless act. Ineffective delivery personnel could cost a freezer provisioner a considerable amount in lost sales. Effective personnel would retain customer confidence and stimulate sales. The business and goodwill they created would multiply many times over.

Officials of the organizations studied stressed the importance of selecting effective delivery personnel. They were aware of the key position delivery personnel filled through their direct, personal contact with customers.

Free Delivery

Twelve organizations offered delivery service free of charge. Needless to say this had a certain appeal to many customers.

Freezer provisioners, on the other hand, are always faced with this problem: Where will the revenue come from to cover costs? Those included in this study generally hoped that free delivery service would stimulate business and thus reduce per unit operating expenses sufficiently to absorb the costs and leave the rate of profits undisturbed. While this was economically possible, insufficient data prevented a precise determination for the firms studied. Some hypothetical examples will help clarify the possibilities.

These examples demonstrate effects on earnings of different ways of paying for delivery service. First, a hypothetical freezer provisioning operation will be set up to use as a standard. Then variations will be measured against it.

The standard organization has assumed annual sales of $150,000. These sales revenues are dispersed in the following assumed manner: 60 percent for cost of goods sold, 25 percent for operating expenses, and 15 percent for earnings. These percentages do not necessarily represent any existing freezer provisioning organization. In actual practice the percentages for these three parts could vary widely from one firm to another and within the same firm from one accounting period to another.

It is further assumed that this standard organization does not offer free delivery service. Hence the standard firm is shown arithmetically as follows:

$150,000 sales, multiplied by
60 percent = $90,000—Cost of goods sold
25 percent = 37,500—Operating expenses
15 percent = 22,500—Earnings
100 percent = $150,000

Suppose this firm introduces delivery service and as a result is able to increase sales by one-third. Suppose further that the increased volume of business results in such operating efficiencies that operating expenses as a percentage of sales revenue is unchanged. Then total earnings will increase by about one-third as shown below:

$200,000 sales, multiplied by
60 percent = $120,000—Cost of goods sold
25 percent = 50,000—Operating expenses
15 percent = 30,000—Earnings
100 percent = $200,000

Again, suppose this firm offers delivery service and as a result is able to increase sales by one-third. Suppose, however, that the increased operating efficiencies are insufficient to absorb all the costs of delivery service. Operating expenses, therefore, as a percentage of sales revenue increase by 2 percent and the rate of earnings declines by a similar amount. Total earnings are still larger than those of the standard organization by about 16 percent. The example follows:

$200,000 sales, multiplied by
60 percent = $120,000—Cost of goods sold
27 percent = 54,000—Operating expenses
13 percent = 26,000—Earnings
100 percent = $200,000

Finally, suppose this firm offers delivery service and is able to increase sales by 67 percent. Suppose further that controls on costs are somewhat lax so that the entire cost of delivery service comes out of potential earnings. Operating expenses as a percentage of sales revenue, therefore, increase by 5 percent and the rate of returns declines by the same amount. Although the rate of earnings declines, total earnings are still about 11 percent larger than those of the standard organization. This example is shown next:

$250,000 sales, multiplied by
60 percent=$150,000—Cost of goods sold

30 percent= 75,000—Operating expenses

10 percent= 25,000—Earnings

100 percent=$250,000

All these examples show total earnings increasing. Needless to say this may not always be the case. It is entirely possible that offering delivery service could be a good investment although total returns decreased. Such would be the case when this service prevented an even greater drop in returns.

The whole emphasis of these examples is pointed toward using delivery service as a means to stimulate sales while at the same time controlling costs. One method used by the firms studied to achieve these two objectives was to deliver free only relatively large orders. This had the benefit of encouraging customers to buy larger orders. Costs also were controlled better because delivery equipment and personnel could be used more efficiently.

The minimum size order (dollar value) that was delivered free-of-charge varied from firm to firm. The typical minimum size order was $50. The minimum ranged from no minimum to a high of $125.

Furthermore, there was no strong positive relation between minimum order and percentage of customers using delivery service. This benefited freezer provisioners in attempting to control costs because they could set a relatively high minimum order for free delivery without discouraging customer purchases.

Not all firms studied favored free delivery service. Two charged for delivery at least under some circumstances. One charged a flat $3 for delivery. In this case about 30 percent of the customers used the service. The other firm offered free delivery in town but charged $3.50 for out-of-town delivery. It imposed this charge to discourage out-of-town deliveries.

These latter arrangements merit further investigation. It may be economically wise to charge a moderate rate for delivery service. This may have the effect of partially covering delivery costs without materially discouraging customers from making large purchases. Any part of delivery costs covered by direct charges will reduce the amount to be covered from other revenue.

These charges can be set up on a zone basis. Then all customers in the same zone will pay the same charge. The charge will be higher in each succeeding zone out from the plant. The differential between zones can be calculated on a percentage basis in relation to the variable costs associated with distance.

Courtesy and Efficiency

The need for emphasis on courtesy and efficiency was expressed so many times by the provisioners interviewed that these qualities deserve special treatment.

They thought courtesy was the key to effective personal service. It made the difference in whether or not delivery service gave a freezer provisioner a competitive edge by the confidence it generated in customers.

The value of courtesy could not be measured directly but customers reacted quickly if it was lacking.

The provisioners considered efficiency essential to make delivery service a paying proposition. This meant developing a delivery system including vehicles, personnel, scheduling, loading, unloading, stocking the freezer, and other facets of delivery in keeping with the size of the business.

One operator succinctly summed up the situation as follows: "Deliver courteously, efficiently, and when promised."

Membership

THE DIVERSITY of views expressed by operators indicated their ideas of membership need further examination and explanation by the locker and freezer provisioning industry. What are the pros and cons? What are the economic consequences? Information gathered in this study frames the problem and presents alternatives. Then each freezer provisioner must decide for himself just as these operators did.

Development of Memberships

Membership—long a distinguishing feature of frozen food locker cooperatives—signifies ownership, patronage, and control.

Membership in this report has a more limited meaning. Here it refers only to patronage. Its usage in this sense came about primarily as a side effect of freezer provisioners' selling homefreezers. The idea was to strengthen the tie between the new freezer owner and the freezer provisioning organization. Such a tie, it was believed, would be mutually beneficial. The consumer would have a reliable source of frozen foods, and the freezer provisioner would have the customer's repeat business.

The idea seemed to work fine at first. Problems arose, however, because some organizations began promoting food plans with the primary thought of selling freezers. After the sale consumers were often left with no reliable source of frozen foods. The situation created adverse public relations that had to be countered by industrywide efforts. The job was not easy.

Industry leaders stressed the fact that reputable freezer provisioners were selling more than just a freezer. They were selling a package deal that included freezer, food, financing, delivery, and a reliable food source among other things. In addition they were selling a new way of living with emphasis upon

consumer convenience. Convenience has a price.

Sales revenue from freezers was not all profit for a freezer provisioner. He incurred some rather substantial selling costs such as salesmen's commissions, bonuses, advertising, promotions, warranties, and so forth in addition to the usual operating expenses. Revenue to cover these costs and expenses came from the sale of freezers.

On the other hand, prices on frozen foods compared favorably with prices in food supermarkets. Consumers were quick to sense an opportunity. Therefore, many of them bought a homefreezer from a discount house or some other source, then came to freezer provisioners for food service. In this way they were able to obtain convenient and reliable food service while avoiding much of the cost associated with such service. In effect, consumers who bought freezers from these freezer provisioners (freezer members) were subsidizing those who did not (nonmembers).

Alternatives

Freezer provisioners generally had these three policy alternatives: (1) To provide unrestricted sales, (2) to institute differential pricing, or (3) to restrict services to members. The 21 firms studied evaluated these alternatives as now discussed and made their decisions.

Unrestricted Sales

Thirteen plant operators decided in favor of alternative No. 1. Seven of these did not sell homefreezers and therefore, were not faced with, among others, such problems as inequality between members and nonmembers, selling homefreezers, and maintaining a freezer sales staff. The general policy of these firms was to sell frozen foods with a minimum of services to all who wished to buy from them.

Firms selling homefreezers had a more complex problem. It seemed apparent that if they continued to give provisioning service to every person who requested it, regardless of where he bought his freezer, it would jeopardize their whole freezer sales and service program. Furthermore, it might antagonize present freezer members because they had paid for services now available to nonmembers without cost.

Some firms decided to discontinue selling homefreezers. These were included in the seven that did not sell homefreezers. Fourteen decided to continue selling homefreezers. Six of them concentrated on selling frozen foods on an unrestricted basis. The remaining eight firms concluded that the best way to protect their freezer sales and minimize customer disenchantment was to restrict their services to members or practice differential pricing.

Differential Pricing

Differential pricing meant the firm maintained two separate price lists. One list of prices applied to members and a higher one to nonmembers. One firm used this method. The differential ranged from 7 to 10 percent on the items listed. The additional revenue from nonmembers defrayed the expenses of offering them equal services with members. Even so the firm was considering changing over to a club membership program because of the cost and bother of maintaining two separate price lists plus the difficulty of explaining them to potential customers.

Over the years a differential amounts to a large sum of money as is illustrated in the following example: Suppose a freezer owner starts patronizing a freezer provisioning organization as a non-

member and this firm maintains a 10 percent price differential to cover the costs of serving the nonmember. Further, this customer reorders a $150 order every 4 months. This means the nonmember will pay $45 a year to obtain the services of this firm. This will amount to $225 in 5 years and $450 in 10 years.

Restricted Service

Rather than maintain two separate price lists seven freezer provisioners restricted their services to freezer members. This worked well except that initially they were cut off from a large potential market for frozen foods—people who already owned homefreezers. A reasonable solution appeared to be to offer them membership. Since they already owned a homefreezer, the usual method of offering membership was inappropriate. Instead they were offered membership by paying a flat fee. This fee was referred to variously as a membership fee, an associate membership fee, or a club membership fee.

Regardless of the name used, the approach seemed to solve a dilemma for these freezer provisioners. Their salesmen were now free to call upon almost any family. If the family did not own a freezer, they would use the freezer approach. If the family owned a freezer, they would use the club membership approach. This practice greatly increased these freezer provisioners' potential market. It simplified administration since only one price list applied and all members were entitled to the same services. It also provided revenue to help defray the expenses of these services.

With this arrangement a freezer owner paid a given flat amount rather than paying a price differential on each and every reorder. The flat fee would prove less expensive for the customer over a long period of time. This can be seen by comparing a flat fee of $200 with the example of a 10 percent price differential given on pages 26–27. In this case the customer would have paid in $225 by the end of 5 years but still not be through paying.

The fees for club memberships varied from firm to firm—$128.50 to $375. Four of the seven quoted a fee of $200.

The firm quoting the highest fee, $375, was rather unique in the manner it arrived at this figure. First it priced its homefreezers competitively with freezers sold by local department and appliance stores. Then it calculated the approximate cost of selling a freezer. This included salesman's commission, advertising, promotion, delivery, installation, and so forth. To this cost of selling was added an estimated profit. The result was $375.

With this system all customers paid the same price for membership in the program regardless of where they bought a freezer. If they owned a freezer, the salesman sold them only a membership. If not, he sold them a competitively priced freezer plus membership.

Firms offering club membership allowed customers to pay the fee over a 12- to 24-month period. Most firms required a downpayment and the balance was divided into equal monthly installments. One firm required no downpayment. If a customer preferred, he could pay cash and save financing costs. One firm even offered a 10 percent discount on cash payments.

Club membership as a percentage of total membership varied from 5 to 50 percent for different freezer provisioners. This additional source of members had a favorable impact on the food sales of these firms and also on their freezer sales. These firms sold an average of 655 homefreezers compared with 155 for those firms that

had no club membership program. This difference may not have been due solely to a club membership program.

Membership Benefits

The firms studied recognized their membership program would be successful only if they had some material benefits to offer. The following list indicates the types of benefits they provided:

1. "All meats unconditionally guaranteed."
2. "All frozen foods are guaranteed grade A and nationally advertised brands."
3. "Wholesale meat cuts processed and packaged to your family requirements."
4. "Free home delivery."
5. "Free home economist service to assist you in food ordering."
6. "Food spoilage insurance policy."
7. "Privilege of purchasing food at our Volume Savings prices."
8. "Monthly bulletins, price lists, and educational food clinics."
9. "Affiliation with a national association making memberships transferrable."
10. "Special Service Contract to reduce freezer maintenance cost."
11. "Profit sharing benefits for referrals."
12. "Life, health and accident insurance benefits."
13. "Up to 40% discount on all appliance purchases."
14. "Convenient terms to budget food orders."
15. "Prompt Repair Service for your freezer at reasonable prices."
16. "Delivery of Frozen Foods in a Freezer Truck."
17. "We will hold your food at zero degree temperature Free if unit can't be immediately repaired."
18. "Cash and Carry benefits."
19. "Any member in good standing can, at any time, consult our C.P.A. as to the validity of our statements and records."

In spite of the listed benefits, some freezer provisioners strongly opposed the sale of club memberships. They held the view that these benefits were generally available and were not solely associated with membership. They questioned also the use of the word "free" in listing membership benefits on the grounds that if customers bought a freezer or club membership they paid for these services.

Therefore, freezer provisioners need to consider the idea of membership, examine the economic consequences, weigh the pros and cons, and make their own decision.

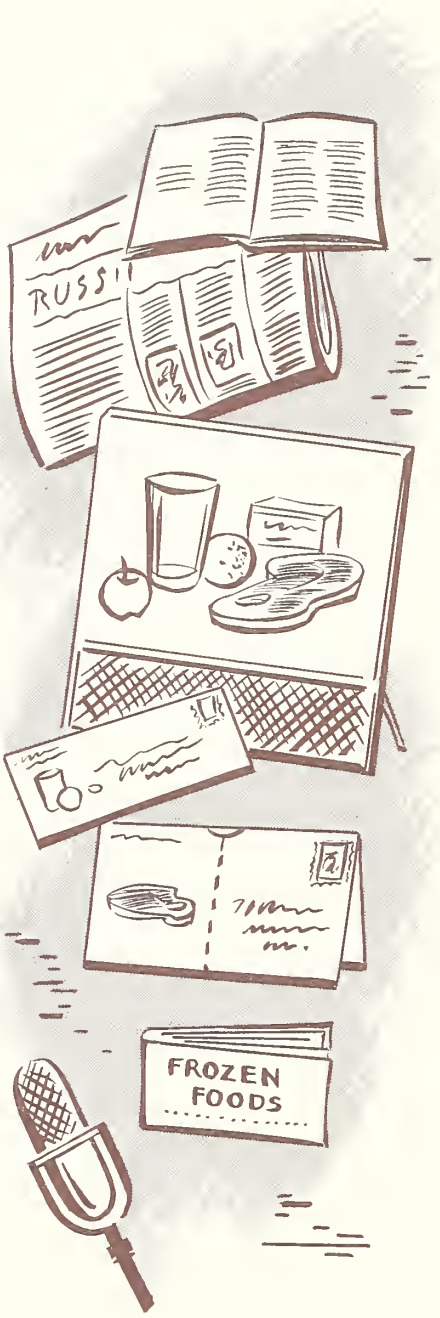
Advertising

IMPORTANT in evaluating advertising are answers to such questions as: Does it pay under given operations and how well does it pay? These were the questions with which the firms in the study wrestled. They had to decide how much to spend on various forms of advertising for best results. There were not any good objective measures for resolving this problem. Their decisions were based primarily upon experience and judgment. But they did not have to rely solely upon their own experience and judgment.

Of the 21 firms studied, 4 used the services of an advertising agency; 7 consulted with the advertising staff of various media; and 10 reported they obtained no external advice on their advertising programs.

Internal responsibility for advertising rested on the owner, manager, or president. Although responsibility for advertising rested upon different people in different organizations and they used a variety of forms of advertising, they agreed on one point—referrals. Eighteen considered referrals to be their most effective means of advertising. This was because it was easier to evaluate accurately than other forms of advertising in terms of the new business it brought in. One operator estimated that about 60 percent of his new business came through referrals. Another concentrated on a formal referral system as his sole means of advertising.

Seven firms employed formal paying referral systems. This meant customers were encouraged to tell friends and neighbors about



their freezer-food way of living. They also sent the names and addresses of these individuals to the freezer provisioner, usually on a form he provided them. Then if the referred individual bought a freezer or club membership, the one who referred him received a specified cash payment, premium, or food credit.

The value of the award varied from one firm to another—$7.50 to $20. Four of the seven awarded a value of $10. Six of the seven paid cash. The other one gave the referrer 4,000 to 6,000 trading stamps.[3]

Two other firms employed formal referral systems. These, however, were nonpaying. In other words customers received forms to list the names and addresses of individuals they thought might be interested in a freezer provisioning program. But the referrer did not receive an award of cash or equivalent value even if a referred person did buy the program.

The remaining 12 firms had no organized referral systems. They solicited referrals from customers on a hit-or-miss basis whenever the notion occurred to them.

Other forms of advertising used in order of their reported importance were local newspapers, direct mail pieces, radio, telephone, out-of-doors signs, television, local parades, and magazines. All operators did not emphasize these media to the same extent but a weighted average favored the sequence mentioned.

Some operators depended heavily upon their own talent and that of their employees to come up with some catchy advertising ideas. Others used mats available from the National Institute of Locker and Freezer Provisioners. Those selling homefreezers also got various amounts and types of advertising assistance from freezer manufacturers. This supplemented the freezer provisioner's advertising budget.

The amount and type of advertising sponsored by freezer provisioners were largely conditioned by the amount of money the provisioners were inclined to spend in this area. The weighted average approached 1 percent of sales. The percentage ranged from less than 1 percent to about 6 percent.

[3] Four thousand stamps were given for recommending a person who enrolled in the firm's club membership program and 6,000 for enrollment in its freezer-food program. The firm also capitalized on the use of trading stamps in other parts of its business, such as 250 for picking up an order of $50 or more, 100 for arranging an appointment with a prospect, 250 with the purchase of a $50 to $100 order, and 500 with the purchase of a $100 or more order. On the last two items the customer also received one stamp for each 10-cent purchase.

Appendix

Description of Participating Firms

THE 21 organizations participating in this study were widely scattered geographically. All regions, except the Pacific, were represented as the following tabulation shows:

Region	*Number of firms*
North Atlantic	3
North Central	9
South Atlantic	4
South Central	3
Mountain	2
Pacific	0
United States	21

Composition of the different business areas in which these firms operated varied from one place to another. Some business areas were predominantly agricultural while others were based largely on light industry, heavy industry, mining, or commerce.

Population of the various business areas, like business composition, was pretty well mixed. Many different races of people lived in the different business areas but they intermingled rather than forming separate individual groups. Only occasionally were sufficient numbers of people of a single race congregated in one group to form a distinctive market potential.

The extent and types of competition these 21 firms faced in their particular business area differed also. Types of competition commonly cited were frozen food locker plants, freezer provisioners, food plans, retail grocery stores, institutional suppliers and custom slaughterers. A few firms indicated they received competition from all these sources. The majority, however, competed with only two or three of these business types.

Another factor also entered into the extent of competition; that was the number of organizations in each competitive group. For example, one firm had competition from eight different locker plants as well as several hotel suppliers. On the other hand, two firms indicated they had practically no competition. For most firms studied the extent of their competition fell somewhere between these extremes. The number of firms competing in a particular business area did not necessarily bear any direct relation to the intensity of the competition.

Neither was it possible to measure exactly the qualitative relation between competition and the number of years a firm had been in the locker and freezer provisioning business. It appeared, however, that the longer firms had been in business the less severe were effects of competition upon them. This was partly because they modified and modernized their operation over the years to build up and hold a loyal following of customers. Such an undertaking takes time and continued attention.

The firms studied had been in the locker and freezer provisioning business from 7 to 22 years. The average was 13 years with almost three-fourths falling between 12 and 15 years.

In terms of types of business organizations, corporations were more numerous as the next tabulation shows:

Types of business organizations	*Number of organizations*
Corporation	12
Partnership	4
Single proprietorship	3
Cooperative	2
Total	21

Seventeen firms rented lockers in addition to serving home freezer owners. This indicates that most firms studied entered the freezer provisioning business by way of a frozen food locker plant. This is important because it shows other locker plants some of the things that can be done and have been done to keep abreast of changing economic conditions. This does not mean to imply, however, that all plants ought to change in the same direction or to the same degree. Changes rather should be geared to anticipated conditions within a particular market area.

Market areas of the different firms studied varied widely in radius. They ranged from approximately 3 miles up to 120 miles. On the average, however, sales were concentrated within about 40 miles of the processing plant.

Sales played a vital role in the operation of these firms although all organizations did not emphasize them to the same extent. The income was from sales, custom services, and rental of storage space. Two types of storage space were rented: (1) Individual frozen food lockers, and (2) piling space for commercial cold storage.

The relative importance of these various sources of income is depicted in appendix table 1. The composite total income figures refer to the income of all the firms from a particular source added together. The composite average is the composite total divided by the number of firms. The high and low figures signify the highest or lowest income any individual firm received from specified sources.

Appendix table 1 gives sales as the major source of income. They accounted for 94 percent of total composite income of the 21 firms studied. The table also highlights the wide range in income from sales ($42,000 to $2,049,000) of the various participating organizations. Approximately two-thirds of them had sales of less than one-half million dollars. This is important because it indicates that all firms in the locker and freezer provisioning industry do not have to be big to be successful. They do, however, continually have to keep abreast of changing conditions.

Meat was the biggest item of sales. It accounted for half the composite total sales as is shown in the following tabulation:

Type of sales	*Percentage of composite total sales*
Meat	51
Home freezers	32
Commercial frozen food	14
Miscellaneous	3
Total	100

All firms sold meat and commercial frozen food. One-third did not sell homefreezers. It should be remembered that all 21 organizations

Appendix table 1.—Composite total and average, and individual high and low income by general sources for 1958

Type of income	Source of income			
	Custom services	Locker rentals	Commercial storage	Sales
Composite total	$394, 000	$112, 000	$52, 000	$9, 286, 000
Composite average	23, 000	7, 000	2, 000	464, 000
Individual high	80, 000	26, 000	40, 000	2, 049, 000
Individual low	0	0	0	42, 000

studied were handpicked. One reason why some of these firms were chosen was that they did not sell homefreezers. Others were selected because they did.

Other factors which help to describe the selected organizations are the various operations performed in each. The percentage of firms performing specified operations is shown next:

Operation	*Percentage of firms*
Process, package, and freeze meat	100
Cure and smoke meat	76
Make pork sausage	67
Render lard	62
Slaughter livestock	43
Make commercial sausage	24

Other Publications Available

Merchandising Frozen Food by Locker and Freezer Provisioning Plants, Marketing Research Report 313. *Bert D. Miner.*

Business Management of Frozen Food Locker and Related Plants, Marketing Research Report 258. *James M. Mullen and Lloyd M. DeBoer.*

Uniform Accounting for Locker and Freezer Provisioners, Agriculture Handbook 163. *Thorton W. Snead, Sr., and Paul C. Wilkins.*

Inedible Offal as a Hog Feed—Processing and Feeding by Small Slaughterers, FCS General Report 37. *Bert D. Miner.*

Highlights and Trends—The Frozen Food Locker and Freezer Provisioning Industry, Marketing Research Report. *L. B. Mann, Paul Wilkins, and Bert D. Miner.*

Management Accounting: For Frozen Food Lockers, Freezer Provisioners, and Local Processors, General Report. *Bert D. Miner.*

Organizing a Farmer Cooperative, FCS Circular 18.

Farmer Cooperatives in the United States, FCS Bulletin 1.

A copy of each of these publications may be obtained upon request while a supply is available from—

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